



e c o n o m i c

# Review

## What Are Institutional Reforms?

Before answering the question "What are institutional reforms?" it is necessary to define the concept of institutions. Institutions involve a set of rules and regulations that define the space in which actors who attempt to achieve particular objectives operate. Institutions exist wherever people realize the need to organize their actions in accordance with the rules set in advance. Thus, the institution of parliament sets the rules under which laws are adopted. The institution of elections sets limits for parties that are competing for power. The institution of private property sets limits under which individuals make profit on the market, etc. Apart from setting limits, institutions serve to divide the functional operations of state, market, and society. Actors seeking to achieve a particular goal or objective choose the appropriate institutions within which to act. The one who wants to pass a law, goes to the parliament; the one who wants to compete for power, participates in elections; the one who wants to engage in production and trade, goes to the market, etc.

The major feature of Institutions is that they are impersonal. Furthermore, they interact with one another, thus producing particular outcomes. The outcomes of parliamentary institutions are laws. The outcomes of the electoral institutions are electoral winners (a ruling party or a ruling coalition). The outcome of the market institutions is the allocation of resources, etc. Impersonality of institutions is the main characteristic that distinguishes democratic from authoritarian system. The problem with the Milošević regime was not the lack of institutions, but the fact they were not observed. Take elections as an example. The institution of elections encompasses several sub-institutions such as election law, electoral committees, party system, electorate, media system, election campaign of political participants and their programmes, etc. All these sub-institutions work in interaction and if they are rationally organized (in that they do not contradict each other), they invariably produce particular outcomes. A system with stable institutions continues to exist after such an outcome has been produced since the actors in such a system accept the outcome whatever it may be. Authoritarian regimes, however, are not compatible with such an impersonal outcome. If he does not like the outcome, the authoritarian ruler interferes and cancels it. This was the case with the institution of elections, as well as with many

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#### Macroeconomic Review

FRY Basic Economic Indicators	2000	2000 1999	IX 2001	IX 2001 VIII 2001	IX 2001 IX 2000	I-IX 2001 I-IX 2000
GDP growth, in real 1994 prices <sup>a</sup>	...	8.4%	...	...	...	...
Industrial Production	...	10.9%	...	5.5%	-4.9%	-3.5%
Montenegro	...	3.7%	...	2.4%	-2.2%	-0.6%
Serbia	...	11.4%	...	5.7%	-5.1%	-3.7%
Central Serbia	...	12.0%	...	4.3%	-11.7%	-7.9%
Vojvodina	...	10.1%	...	8.2%	9.1%	6.0%
Average nominal net wage - Serbia in Din. <sup>1</sup>	2,389	89.5%	6,210	1.9%	141.1%	138.1%
Real net wage - Serbia <sup>1</sup>	...	5.5%	...	0.1%	22.2%	9.1%
Average net wage - Serbia, in DEM <sup>1</sup>	93	-11.2%	203	1.8%	140.1%	143.1%
Average net wage - Serbia, in DEM <sup>2</sup>	...	...	226	1.3%	...	...
Average gross wage - Serbia, in DEM <sup>2</sup>	...	...	326	1.3%	...	...
Unemployment Rate - registered <sup>3</sup>	28.38%	...	29.9%	0.6%	3.9%	4.4%
Montenegro	...	...	39.2%	0.3%	...	...
Serbia	27.45%	...	29.2%	0.7%	4.9%	4.9%
Current account, in USD millions	-1,298	3.2%	...	...	...	...
Trade balance, in USD millions	-1,989	-10.6%	-153	9.3%	12.5%	17.1%
Export - USD million	1,713	15.0%	159	22.3%	2.1%	3.5%
Montenegro	157	31.1%	2	-77.8%	-83.2%	-1.6%
Serbia	1,411	13.8%	157	14.7%	9.9%	4.2%
Import - USD million	3,662	12.6%	312	15.6%	5.9%	21.1%
Montenegro	313	-1.0%	16	-40.7%	-8.9%	35.8%
Serbia	3,035	15.6%	293	21.7%	6.7%	18.9%
Monetary supply (M1), end of period, in DIN billion	29.6	60.7%	52,623.0	8.39%	121.52%	103.44%
Cash	10.3	39.8%	17,640.6	9.45%	94.88%	89.56%
Deposits	19.3	74.9%	34,982.4	7.86%	137.93%	111.76%
Real money supply, end of period, in DM million	1,043	-26.7%	1,723.64	8.21%	139.39%	82.90%
Hard currency reserves, in million USD (end of period)	524	76.2%	1,048.30	10.3%	...	...
Discount rate	...	...	1.30%	-18.75%	-35.00%	-24.00%
Market interest rate, monthly level	5.84%	37.3%	4.32%	-12.90%	-33.74%	-8.79%
Retail prices - Serbia	...	70.0%	...	1.4%	104.5%	116.3%
Consumer prices - Serbia	...	79.6%	...	1.8%	97.3%	118.3%
Producer prices - Serbia	...	102.6%	...	1.5%	88.2%	111.1%
Average exchange rate - Din./DEM	25.45	103.2%	30.53	0.2%	-0.8%	26.7%

<sup>a</sup> Figures refer to FRY without Kosovo

<sup>1</sup> Comparable to the average net wage calculated according to the method applied until June 1, 2001.

<sup>2</sup> By the gross wage calculation methodology applied as of June 1, 2001.

<sup>3</sup> Figures refer to August 2001.

## **Main targets of institutional reforms: impersonality and impartiality of institutions**

## **Two aspects of economic reforms: withdrawal of the state from the economy and establishing new market - orientated institutions**

## **Democracy - a system where ruling parties lose elections**

other institutions under Milošević. Whenever Milošević did not like the outcome arrived at through the interaction of compatible institutions, he tried to alter or annul it.

It is now clear what institutional reform is all about. Reforms in Serbia should be aimed, above all, at organizing the institutions that would, rather than actors, affect the outcome of the political process. A political system in which the participants have the power to ex ante or ex post revoke the outcome brought about by the interaction of institutions is not a stable one. The difference between authoritarian and totalitarian systems, as well as various kinds of dictatorship, and democracy is that the institutions in an authoritarian regime are so weak that the actors are able to alter the outcome of institutions whenever they want.

The reform of economic institutions requires that the outcome of economic the activity of an actor stem from the logic of institutions, not from the intervention of actors. Economic reforms can be divided into two parts. On the one hand, they require drawing a firm distinction between the state and the economy. On the other hand, economic reform means the establishment of particular market institutions that specify property rights and facilitate trade and exchange. The first aspect of reforms includes liberalization of market entry, liberalization of prices, reduction of budget expenditures, liberalization of business banks, liberalization of wages, and, as the most important aspect, privatization. However, the withdrawal of the state from the economy is just one part of the economic reforms since in communist economies many economic and market-oriented mechanisms had not existed at all. Therefore, the second aspect of economic reforms is about establishing a legal framework for new market-oriented institutions. This includes legislation on trade companies, monopoly, labor markets, foreign investment, international trade arbitration, laws that establish and regulate financial market, etc. In short, economic reforms are about establishing a framework for production, trading and making profit, where the market as an impartial "umpire" is to have the decisive role in the allocation of resources.

Both these aspects are necessary to define institutional reforms in the economic sense. This is easy to comprehend if we keep in mind the fact that most of these laws existed both in socialism and the Milošević regime. That a great many number of these laws were not fully market-oriented was not the only problem. The state had significant influence on the economy in two senses: first, it constantly did, and in particular occasions it had to, arbiter between different participants in the economy; second, the institutions were not impersonal but highly subject to individual interference. Liberalization of the economy requires a reduction of the number of decisions that could be, even theoretically, influenced by the state. This part of institutional reforms has been more or less successfully carried out in most countries undergoing the process of transition. For example, the fact that the prices are no longer controlled or that free purchase of foreign exchange is allowed means that the state is no longer a sovereign economic participant that decides who sets the prices, or who controls foreign exchange under favorable rate of exchange. In many countries of Central and Eastern Europe institutional reforms slowed or even stalled at this point. The second, much harder aspect of reform is to create the base for a system where the application of economic law is not under the influence of powerful individuals and political circles. This step is on the way of realization in only a few transition countries. These changes are much more complicated. Firstly, the realization of these changes is harder to control by either domestic or foreign subjects (the existence of a law is not questionable, but the way this law is put into effect is subject to various interpretations and very often not transparent). Secondly, it requires that circles with the power to guarantee certain outcomes submit themselves to impersonal institutionalized rules and uncertain outcomes. Therefore, the implementation of the second aspect of institutional reforms will be very hard to accomplish in the Serbian society as well. Only a one-year experience with transition in Serbia confirms that. While progressing well in the first aspect of institutional reforms, we have not gone far with the second one.

From everything that has been advanced so far, it follows clearly that the main difference between authoritarian and democratic systems is that in the latter the possibility for the actors to interfere with political process by avoiding institutions is reduced to a minimum. However, there have been some authoritarian regimes based on the predictability of institutions. Therefore, it is important to emphasize that there must not be just any institutional reform, but the reforms that establish a democratic polity. The most general understanding of democracy, which distinguishes it from kinds of authoritarian and totalitarian systems, suggests that in democracy there are decisions directly or indirectly made by all people. The most suitable definition of democracy, suitable for the understanding of institutional reforms in Serbia, is the one formulated by Joseph Schumpeter in his book *Capitalism, Socialism and Democracy*. In Schumpeter's view, democracy is a method by which the citizens are entitled to select who is to make political decisions. The role of the citizens is only to elect a government choosing among different political parties. Everything else is to be solved at the level of political elites. Democracy is not the rule of the people but rather a rule of politicians, though a kind of a rule where the people can protect themselves from the abuse of power by replacing politicians in the next cycle of elections.

Democracy is a system where ruling parties lose elections, while the result of democratic elections is unpredictable. The participants who are competing for power attempt to win elections, but since each step depends on what other side does, the result of the elections cannot be predicted. The outcome of democratic process is uncertain, but it does not mean that nothing can be predicted. Democracy is neither chaos, nor anarchy. Uncertainty means that the actors know what might happen, but not what will happen exactly. Democracy is uncertain only in latter meaning of the word. The actors know what might happen since the possible outcomes are brought about by institutional framework they act within. They know what is most probably to happen since the probability of each single outcome is determined by the institutional framework and by the resources engaged by different political parties during elections. Yet, the precise outcome that will come about remains unknown.

Institutional reforms are not to be understood as a completed act, but rather as an ongoing process. The reforms might be initially successful, but endlessly slow, as in Romania and Bulgaria, or they may even fail, as in Russia. A democratic system is established when the basic institutions are consolidated. Consolidation means that the main political and economic actors willingly accept the rules established by the institutions. They accept the outcome of economic and political processes even if it is not to their advantage. In the system of stable institutions, there might be disagreements and disputes over distribution of resources, but basic institutional rules could not be a subject of these disputes themselves. In Central and Eastern Europe, institutional reforms started after the failure of Communism. However, the reforms have not been successful everywhere simply because, soon after establishing them, the actors began to change, revise or, as Milošević did, ignore them. Institutional reforms mean the establishment of institutions that by their nature constrain the actions of the participants. This is not easy to accomplish since an external authority could not establish the institutions, but only by the participants whose actions these institutions are to constrain. The establishment of institutions and their reform are full of temptation. However, the success of institutional reforms is precisely about overcoming this temptation. The actors must commit themselves to establishing basic political and economic institutions that would not be changed, modified, revoked, or ignored for the sake of short-term political goals.

## Constitutional Reform in FR Yugoslavia

### The Type of Federal State

Constitutional reform of the federation began in January 2001, when President Koštunica offered "A Basis For a Joint Platform on the Constitutional Reorganization of FRY" (hereinafter: the Platform) to the Montenegrin Government for consideration. Apart from this Platform, there are two other proposals circulating in the public at the moment: the first, drawn up by the Belgrade Center of Human Rights in August 2000, contains both a federal and confederate solution; the second is worked out by the Center for Liberal-Democratic Studies in Belgrade (hereinafter: the Proposal). Since the Platform is a shorter version of this Proposal, and the Belgrade Center for Human Rights federal solution is more or less a copied version of it, we are largely going to analyze the Proposal.

The new idea in the Proposal is an attempt to define the context within which a new constitution can be adopted. The 1992 Constitution of FRY was adopted in the period of disintegration of the former Yugoslavia, when it was necessary to politically strengthen the two political elites in power. The Constitution was an instrument that was meant to justify Milošević's alleged effort for the survival of Yugoslavia. In the Proposal, there is a new context where Yugoslavia is seen as a functional union based on the principles of efficiency and equality. Efficiency refers to the decision-making in federal bodies; equality aims at preventing the outvoting of Montenegro as a smaller federal unit. As it will be shown later, the context so defined has a decisive effect on almost every institutional solution that can be found in the Proposal. The context itself is well defined, but the offered solutions are not.

The proposal fails to take into account aspects that are critical for refurbishing the distorted ties between Serbia and Montenegro. The definition of context neglects the existing situation in which Serbia and Montenegro are practically two sovereign states. Under such circumstances, the federal state could be erected only with a kind of state contract where Serbia and Montenegro would agree to hand over a part of their prerogatives to the federal state. The proposal simply assumes a national energy and willingness of the Serbian and Montenegrin people to have a joint state. At this moment, however, such will and energy is at best an alleged fact.

The Proposal avoids repeating articles of the existing federal Constitution that define Yugoslavia as a sovereign state, but rather attributes sovereignty to the citizens of Serbia and Montenegro. This solution fully corresponds to the principle of subsidiarity by which public policies are formulated and executed at the lowest practical level. By the principle of subsidiarity, lower levels are sovereign and transfer their prerogatives to higher levels only if they are not able to pursue their policies themselves. The principle of subsidiarity is usually preceded by the view that there are a number of functions that could not be realized within federal units, but only within the federal state. These could include, for example, a joint defense and currency. The proposal defines subsidiarity as a principle "that allows federal state to use only those functions that will be better and more efficiently realized at the level of the union rather than at the level of federal units." This solution is in agreement with the definition of subsidiarity, since subsidiarity does not allow a clause permitting the union to assign prerogatives to itself, but it is not in agreement with the concept of original prerogatives that the union, according to the Proposal, should have.

That is, the Proposal cannot come to terms with who is really sovereign in the union. It explicitly rules out the possibility for the federal government to have any original powers, claiming that "it can be attributed new power only if this is agreed by the federal units". The assumption is, as can be seen, in favor of federal units. But the reading of the word "original" in the Proposal leads to the conclusion that the federal state sets the volume of its affairs independently. That the Proposal confuses "original" and "transferred" prerogatives is clear from the proposition that "the federal government is allowed to pass its prerogatives to the republics or their administrative bodies." It sounds absurd that the union can transfer back to the republics something the republics had previously transferred to the federal state. A consistent implementation of the principle of subsidiarity mandates that the union cannot possibly have original, but only transferred powers. To avoid confusion, it is necessary to separate the term "original power" from the term "policy that the union pursued autonomously". Even if it is possible to have some fields where federal bodies autonomously pursue policies, these prerogatives can by no means be original but only transferred. Such solution is absolutely compatible with what was stated in the Proposal—namely, that the union of Serbia and Montenegro "will be in charge of only those affairs without which the union system will not be able to function efficiently." The fundamental idea of federalism is exhausted in the equal representation of federal units in the federal bodies. What policy these bodies are going to pursue after being established is another question.

### Four proposals on the constitutional reorganization of FRY

### Labus makes his assessment

### Subsidiarity: sovereignty to the citizens of Serbia and Montenegro rather than to the state

### **The institution of the president without direct elections**

#### **The Structure of the Government**

The Proposal basically preserves the existing structure of government, introducing slight changes. It foresees a bicameral parliament, president of the state, and a government organized by the chancellor model. Although the Proposal was published in June 2000 and is not familiar with Amendment V, which replaced Article 97 of the 1992 Constitution and introduced direct elections for the President of FRY, it nevertheless insists on indirect elections for the president. The exclusion of direct election of the president is justified, as this solution, by and large, had a sweeping effects on further worsening of relations between Serbia and Montenegro during 2000 as well as on the change of political system in Serbia after federal elections on September 24, 2000.

The Proposal offers a new rationale for the function of the president. It says, "the President of the republic is a person of undisputed public reputation in the whole country where he acts as politically neutral authority, which is the best recommendation for presentation of the country abroad. Therefore, there should be a constitutional recommendation that the President of the Republic abstain from representing any political party." Such a rationale for the function of the president that insists on his neutrality surely merits applause.

However, in the current political constellation, the question is if it is possible at all to find such a neutral person in the Serbia or Montenegro. The president represents the country, but he usually should represent all the citizens of that country as well. All Yugoslav presidents so far have acted at least partially, i.e. as representatives of their parties, or, in the best case, as representatives of the Serbian people. This practice is far from abandoned despite the October changes. Only a few months after October 5, President Koštunica has been declared in Montenegro and Vojvodina as a successor of the Milošević practice. This has affected Koštunica's popularity, which plummeted from 59.3% in December 2000 to 32.1% in August 2001. More indicative is citizens' trust in the institution of President of the Republic. While in September 1999 it was 23%, after political changes it increased to 74% in June 2001, but decreased again to 62% in August.

The institution of the president in the Serbian and Yugoslav context has damaging effects on the development and consolidation of democracy. The main reason is that the President, without having a prerogative for doing so, attempts to pursue his own policy. This practice leads to so-called "dual executive." Although the President, under the Constitution, is not the supreme commander of the army, in time he has developed a special relation with the highest military officers, thus delimiting the army's civil control. The persistent postponement of reform of the Yugoslav army, the only institution untouched by the reforms after the October changes, says it all. A model of dual executive is blurring the answer to the question who is in charge of the FRY military forces, since there are at least three institutions that deal with the Army: the President, the Prime Minister and the Minister of Defense. Yugoslavia has a federal structure and therefore the number of subjects is increasing. The control of military forces in Yugoslavia today is less constitutional, and more dependent on informal agreements between the Yugoslav President, who is in charge of the army, and the Serbian Prime Minister who is in charge of the Serbian police forces.

Apart from suggesting the abandonment of direct elections of the president, the Platform does not really touch other prerogatives of the President. Although both the 1992 Constitution and the Proposal foresee the President's responsibility in the case of a violation of the Constitution (and an attempt to pursue his own policy by all means constitutes a violation of the Constitution), it might be safely assumed that the President will continue to work in such a manner without suffering any legal or political consequences. The authors of the Proposal are aware of this danger and, in order to diminish the President's influence as much as possible, they suggest a new solution by which "it is required for all acts of the President of the Republic to be previously countersigned by the federal Prime Minister." If the President is not allowed to make any decisions that are not previously counter-signed by the Government, is not it then more rational to dismiss the institution of president completely from the constitution, and transfer all his prerogatives to the Government?

As already mentioned, the Proposal, supporting the idea of a minimal and functional federation, makes a radical departure from the existing Constitution. The Proposal drastically reduces prerogatives, confining them to basic rights and liberties, international relations and foreign policy, national defense and foundations of the economy system aimed at protection of a united market. In the background of this solution lies a hope that such a reduced list of prerogatives might make the federal state more attractive to Montenegro, since Montenegro has already independently taken on a number of prerogatives that, under the current Constitutional solution, are supposed to be under the control of the federal state. However, in order to meet the needs of Montenegro, and to insure equality, it is not only critical to reduce federal prerogatives, but also to redefine how federal authorities are arranged and how they make decisions. The Proposal completely fails on this point because it maintains majority decision-making in the Chamber of Citizens and restores the chancellor system of government.

### **Minimal and functional federation**



The Parliament is to consist of two chambers, one elected by a majority system and the other by proportional system. Decisions, however, would be made on a consensual basis: a law cannot be enacted if both chambers do not vote for it. The Proposal revokes Amendment VIII of July 6, 2000 that introduced an indistinct way of election of the government and restores the chancellor model of government, which is based on majoritarian decision-making. The solution that better secures equality with respect to decision-making is a consociational model. The consociational model is opposed to the majority in that it avoids decision-making system that by definition excludes the minority. In majoritarian democracy, the majority makes all decisions. In a consociational democracy, the decisions are, by and large, made by all. Like the majoritarian model, the consociational one also accepts majority decision-making, but this is only the minimal condition. Instead of a simple majority, this model tends to demand super majorities. Besides, the consociational model is focused on division, dispersion and limitation of power. When it comes to the government's policy, the most noticeable conceptual difference is that the majoritarian model is based on exclusion (of the minority), competition and rivalry, while the consociational approach is based on inclusion (of the minority), bargaining, and compromise.

The consociational model is convenient whenever there are at least two separate entities. It serves to block the possibility of outvoting the minority. In countries such as the U.S., the United Kingdom or New Zealand, the damaging effect of majority decision-making over the minority are easily overcome, as today's minority can become tomorrow's majority. This cannot possibly hold in any variant of Yugoslav federation, since there are no federal parties. If we apply an ideal majoritarian system at the federal level, it would put Montenegrin parties in the constant minority. Of course, the 1992 Constitution, as well as the Proposal, are a far cry from mandating the ideal majoritarian democracy and do have conspicuous traces of the consociational idea. Yet, an alternative solution, which is defended in this analysis, would seek to implement consociational principles in full.

The fact that in FR Yugoslavia, even during the most harmonious period between Serbia and Montenegro, there has never been any federal party to participate in elections at federal level, is a reason enough to reject the solution of the Proposal and settle on a consociational model instead. According to this approach, there would have to be parity in the structure of all federal organs. The federal parliament would consist of two chambers: one whose representatives are elected directly, but with an equal number of representatives from each republic, and the other consisting of delegates sent directly by the federal units or elected by the unit's parliaments according to the representation of particular parties in them (a ratio of 20:20 is enough in both chambers). The federal parliament would make decisions upon consensual principle in both chambers, but in each chamber a consensual voting would be mandatory.

The same solution is necessary for the federal Government. The consociational model suggests that the government should consist of an equal number of ministers from each republic. According to the present solution, advocated also by the Proposal, there is a chancellor type of government. This solution, taken over from the German Grundgesetz, means that firstly the Parliament agrees on the choice of Prime Minister who is then free to choose ministers, not respecting the party basis. If he finds it suitable, all the ministers can come from Serbia. The Prime Minister also does not have to respect the party structure of the Parliament. He may choose ministers from any party, as well as experts with no party background. This model is in full compliance with the majoritarian principle of decision-making due to the leading role of the Prime Minister. The consociational model differs here on two points. Firstly, a government is formed by the parity principle, meaning an equal number of ministers is guaranteed to both republics. Secondly, ministers are delegated by leading coalitions from both republics, and the Prime Minister is to accept the decision made by the republics. He has no influence over the selection of ministers. As for decision-making within the government, the consociational model is based on absolute consensus.

It is worth pointing out that the Federal Government voted in on July 24, 2001 is formed on the consociational principle. The two leading coalitions, DOS and "Together for Yugoslavia" first agreed on the number of ministers and division of Ministries, and then president Koštunica appointed the prime minister who had to accept the composition of the Government as a fait accompli. Soon after, the Government adopted the consensual principle in decision-making. Hence, the appeal of the consociational model lies in the fact that solutions which have already given results in reality are the best ones.

An objection to the consociational model suggests that, due to the complicated consensual decision-making, this model is inefficient and might have harmful consequences on the implementation of a government's policy. Consensual decision-making is perhaps somewhat slower, but there is no reason to believe that relative slowness in decision-making necessarily implies inefficiency in implementing the policy. Some studies showed that there is no difference between consensual and majoritarian decision-making when it comes to economic growth, inflation, unemployment, etc.

**A Parliament of two chambers...**

**The consociational model of government**

**A Chancellor led government distorts the equality of Serbia and Montenegro**

### Attraction and efficiency of consociational models

But it should be stressed that, on the consensual model, the federation will anyhow not be in charge of this kind of affairs, for these will remain the prerogatives of the federal units. The federal government is to deal with strategic decisions concerning European economic, political and military integration (joining the EU or NATO, for example) that do not require the speed necessary for decisions concerning economic policy, but require the widest possible consensus in acceptance of these strategic decisions. Only the consociational model can guarantee this.

### Confederate Solutions

The Montenegrin Platform of December 28, 2000 and an alternative version of a confederate Constitution drafted by Belgrade Center for Human Rights, as opposed to the Proposal and the Koštunica Platform, offer a confederate reorganization of FRY. In the Montenegrin Platform, the new relationship between Serbia and Montenegro should be based on a definition of Serbia and Montenegro as two internationally recognized states "mutually independent in the questions of their state and national sovereignty and in realization of their interests" with maximum decentralization.

Although basically confederate, the Montenegrin Platform, as well as the Proposal and the Koštunica Platform, implies a functional union. It is said that for both Serbia and Montenegro, "the only acceptable concept is the one based on a constitutional position of states as original holders of sovereignty, that pass a part of their affairs to the joint bodies, as those affairs could be equally, rationally and fully accomplished at the union level." While the Montenegrin Government sees a new union as a functional one, the solutions that can be found in the Platform cannot be said to correspond to the idea of functionalism.

In part IV titled "Prerogatives of the Union of Serbia and Montenegro," the Montenegrin Platform suggests three areas that the Union be charged with — defense and security of the Union, foreign policy of the Union, and the provision of joint market and convertible currency. The prerogatives are allegedly transferred to the Union, but the Platform clearly postulates that the very same prerogatives originally spring from the sovereignty of the republics. If Serbia and Montenegro are to have their own military forces, formulate and pursue their foreign policy independently, and have their own currency, the only reason for the Union to exist will be the coordination of these activities. However, if the Union is reduced to the coordination of the activities, the question is why maintain any form of political union in the form of a quasi-state framework with the government, parliament and the president of the state? Joint bodies for coordination of two independent policies established by an intentional agreement would be a more appropriate solution for that matter.

The Belgrade Center for Human Rights confederate Proposal does not combine federal and confederal elements in a particularly suitable way. Generally, in both a federal and confederate system there exist a central body but with significantly different characters. In a confederation, delegates appointed by the governments of two separate states who vote after obligatory instructions wield state authority. Their decisions are made unanimously and are obliging only to their governments (states), but not to the citizens of separate states. Only after confirmed by the authorities in each separate state, are these decisions obliging for the citizens. Accordingly, the central power in a confederation resembles more a diplomatic congress than to supreme power. But the BG Center confederate Proposal suggests organs such as a parliament, president and government, and these organs are constituted and make decisions in a federal rather than confederate manner. The procedure of decision-making in the parliament is complicated, as it requires at least 51 representatives to vote for a decision, but the decision could be made only if at least 11 representatives of each republic vote for it. Although the procedure of decision-making is complicated, it is basically federal, not confederal.

Furthermore, the parliament elected on "direct elections by a secret ballot" is seen as formulating and pursuing its own policy. Sovereignty is assigned to the citizens of Serbia and Montenegro, instead of being assigned to the republics founding the confederation. All this does not cohere with the idea of a confederation as defined above. The BG Center proposal shows the main collision with the principle of confederation by allowing for the interpretation that the confederal government pursues its own policy. All in all, this confederate Proposal is closer to a consociational model, as it suggests parity in the number of ministers in the government. But a consociational model is basically federal, not confederal.

In practice, confederations have long ago proven to be an outdated form of political integration. All confederations from the 18th and 19th centuries turned in time into federations (Switzerland, Germany, and the USA) or into simple state (the Netherlands). Relations between states are nowadays arranged through various forms of participation in international organizations that did not exist in the 18th and 19th centuries. Therefore, there is no need for Yugoslavia to become a confederate state today.

### Confederate proposals are out of date and not coherent

## The Paths of Reform

*From this volume of the Review forward, apart from presentation of economic reforms, their monitoring and analysis, we are going to deal with institutional and legal reform as well. We will monitor about twenty areas of society, state and economy. At the beginning, we are presenting the methods and objectives for the first several areas we are dealing with in the course of the project.*

### Legal and Institutional Framework

The experience of transition countries clearly points out that success in the realization of legal and institutional reform has a crucial influence on the speed, success and course of other reforms. Therefore, it might be said without exaggeration that legal and institutional reform is a turning point in the pro-reform orientation of the government and the citizens of a particular country. FR Yugoslavia is not an exception. The majority of the population agrees on the necessity and the course of implementation of this reform, which is not the case with other areas that require reforms.

There are numerous (economic, legal, sociological) reasons that justify systematic, universal and critical analysis of the problem. In the view of economic parameters, long-term positive effects of the implementation of legal and institutional reform are certain, even though at first it seems that the transitional expenses of its implementation exceed the expenses of maintaining the current situation. In a legal sense, without implementation of legal and institutional reform, other reforms (financial, monetary, etc.) that are carried out at present would be left without institutions and legal mechanisms that guarantee their implementation, which is a prerequisite for investments and other forms of economic cooperation with the international community. In the view of sociology, legal-institutional reform brings back the thrust in a real pro-reform orientation of the state since the citizens' trust gradually decrease over the course of time; it consolidates thrust in the persistent preservation in reforms.

Numerous objectives that the project attempts to achieve correspond to the complexity of the issue of legal and institutional reform. It must be emphasized that the establishment of a legal framework, i.e. the level and the territory where the reform is to be carried out, is unbreakably connected to a clearly defined political framework. In addition, it should be stressed that the maintenance of a status quo in the judicial system is harmful. Some legal areas and institutions should be reformed, revoked or established as new ones. The population should be informed about the prospects, real expenses and speed of reforms. At the same time, a criticism based on comparative jurisprudence, legal standards of the EU and international community, and empiric research should all be directed at what the creators and the executors of reform policy are doing. Finally, we must conduct an analysis of the current situation in legal institutions and areas where the reform has been implemented and results achieved.

### Corruption

Corruption is one of pressing issues in all countries in transition, including our own. According to all polls and research of public opinion, corruption is noted as one of the biggest and most important problems in transition countries.

Corruption is a hidden threat ruining the whole of society. It is also a complex phenomenon that raises many questions and must be observed from several different viewpoints (economic, political, legal, social, etc.). However, in the view of weak economies of countries in transition, all quantitative researches showed negative economic effects of corruption. It unproductively spends the scarce resources these countries dispose of, and thus threatens to slow, or even stop all democratic changes.

Numerous objectives of the analysis correspond to the complexity of the phenomenon itself. It is necessary to keep pointing to the danger and even to the presence of corruption in our country, with clear and documented information about the areas, public services, and individuals intertwined with this process. Persistent education and informing the citizens is important as well, in order to make a wide public front for the battle against corruption. Criticizing the actions of the state in the area of legal regulation, as well as reform in public services and state administration where the corruption is present is also required. Finally, constant economic analysis of corruption should point at its high cost to society and the state.

**Economic, legal and  
sociological rational  
for institutions**

**A hidden threat  
ruining society**

**A quick return to international political and financial institutions**

**Comparative experience is key**

Monitoring is not an aim for itself. Pointing at the causes of corruption and the problems in the battle against it should result in measures and methods of an anti-corruption battle and to maximize the reduction of lost time.

### Reintegration

One of the promises of the new authorities largely fulfilled this year refers to the fast return to international political and financial organizations. Yugoslavia has officially applied to join World Trade Organization (WTO) and the process of admission to the OECD has started. Most significantly, Yugoslavia and the EU have started negotiations on an "Agreement on Stabilization and Association". The membership in EU is marked as a priority and strategic interest of FR Yugoslavia.

The reintegration of Yugoslavia in international political, financial and economic institutions is very important for several reasons. Keeping in mind our ten-year experience of isolation and alienation from the international community, there is no need for emphasizing how much it is important to participate in a modern integration process. Political and economic effects of membership are mutually connected. As for the size and condition of our economy, economic effects are significant indeed. Membership in international organizations provides numerous direct benefits (financial support, expertise, and access to international markets), as well as indirect benefits. Membership in these organizations guarantees foreign investors that a country respects internationally established rules.

Monitoring and encouraging the process of reintegration into the international community is of crucial importance for Yugoslavia. This research is led by stressing the meaning and significance of this process for our economy, population and living standard, through analysis of different views based on experiences and achieved results of other countries in transition.

### Privatization

Privatization is vitally important for Yugoslavia; especially regarding the financial impact expected after the adoption of a new Law on Privatization and subsequent acts in Serbia (June – July 2001) and in Montenegro (2000). Monitoring and analysis of the process of privatization is focused on transparency and legal protection of direct foreign investments and investors in general. The privatization of about the 40 biggest socially-owned enterprises as well as of 4,000 smaller companies will result in an increase in efficiency of restructured enterprises. On the other hand, privatization is followed by numerous social issues of redundant labor and the need for a reduction of corruption.

Therefore, the analysis and recommendations on privatization, in the view of legal and institutional reform, are aimed at providing the Government and competent Ministers, as well as leading participants in privatization, with an insight into reactions of experts, public support and/or public criticism. A significant factor for research in this area is comparative experience of other countries in transition that have already carried out or have been carrying out privatization more or less successfully. The support of citizens is by all means necessary for success of the process, as well.

The task of analysis and recommendations is directed at pointing out possible problems and obstacles during the implementation of privatization and possible solutions for overcoming them.

### Infrastructure

Although it might be looked at from different aspects, in the view of legal and institutional reform of infrastructure, we are going to monitor changes in the electric-energy and traffic network. We are interested in the development of regulations in these areas, and in integration with international institutions. With regard to their nature, most changes are expected in the regulation of standards.

Traffic means the transportation of people and goods, i.e. the organization of transportation, but also the "transportation" of news, which include telecommunications. The electric-energy system and its provision of constant supply are *conditio sine qua non* of every modern economy. This became obvious after the crisis in 1970s and that's why these two areas are considered together.

In order to join the EU, Yugoslavia has to first initiate regional integration. Therefore, Yugoslav membership in the Pact for Stability of Southeastern Europe is very significant. Within the Pact, most actions have been carried out in infrastructure projects so far (road network, railroads, telecommunications, river transportation). Since September 27, Yugoslavia has been a member of CEMT, the Conference of European Ministers of Transportation.



The transit position of our country and the actual situation (physical separation from Greece, an EU member; the shortest land route connecting Europe and Asia, including the Near and Far East; the longest shipping road through the Danube regardless of the fact that shipping is discontinued at present; projects on gas line and oil pipeline) are attractive enough for foreign investors, especially regarding the plan that two Transeuropean corridors are to pass across our country. Attention should be paid to the plans on development of an EU traffic and electric-energy network by 2010. (September 2001, White Book). In the view of these facts, the relatively high costs of infrastructure reforms could be resolved.

### Legislation on the Economy

The new authorities have set the reintegration of Yugoslavia in financial and other international institutions as a basic objective. The priority is admission to the EU, while the first step is admission to the Council of Europe projected for next spring. A transition period would be less painful if coordination of domestic legal enactments with EU regulations starts right away. In view of the fact that it is hard to expect coordination of the whole *acquis communautaire*, it is necessary to begin reforms in accordance with the instructions given in the White Book on preparation of joined countries of Central and Eastern Europe for integration into inner market of the Union. Of 23 areas encompassed in the White Book, the majority refers to economic and related legislation. Therefore, the main objective in this part of the project is monitoring and analysis.

The European Union has recently adopted a Statute of European Society that enables companies, which carry out their activities in several member countries of the Union, to be constituted as European companies and to develop into a unique economic subject on the territory of the Union as a whole. This means there will be unique regulations, systems of administration and publication of financial information in order to avoid the adaptation to dispositions of national legislation and passing through long-lasting and expensive administrative formalities when establishing a network of branch offices.

The first step in Yugoslav reforms might be a transition from the concept of enterprises to the concept of trading companies that would require amendments to existing Law on Enterprises. It encompasses restructuring, financial consolidation and status and organizational changes of particular public enterprises into trading companies, as well as of socially-owned enterprises to one of the existing forms of limited liability enterprise or joint stock enterprise.

If the transition to the concept of trading companies is accepted, this wider area will encompass monitoring of related regulations, especially these concerning: bankruptcy and liquidation, anti-monopoly legislation and rules on competition, foreign investments, public acquisition (not regulated by law at present and it is necessary to create and adopt a law on federal level as soon as possible), and the promotion of small and medium enterprises by adoption of both federal and republic laws.

Monitoring and critical analysis of reforms in this area is in process, together with proposals of solutions for making domestic legislation closer to European standards, while taking care of the situation and specific characteristics of our economy. The aim is to contribute to the recovery of economic activities and preparation for business on a universal European level.

### Fiscal Reform

One of the few areas where reform has already started in the second trimester of this year is fiscal reform on the territory of the Republic of Serbia. The Yugoslav Federal Parliament had not adopted the Law on changes and additions to Law on the basis of tax system as of July 2001. The Republic Law is largely, but not completely, in compliance with the Federal Law on the basis of tax system, whereby all controversial solutions are better solved in Republic Law, while those from Federal Law are a little old-fashioned.

We must build absolutely informed taxpayers with clear and exact knowledge of what they pay, why they pay and what they get in return for the money; and which officials are in control of the reporting, calculation and payment of taxes.

Therefore, monitoring of the effects of implementation of fiscal reform, legislation and other subsidiary legal acts, analysis of the extent of acceptance of reforms by economic subjects and the population, and estimation on applicability of particular solutions, as well as proposals for certain changes, are aimed at a faster and complete integration into international economic and financial flows.

**Yugoslavia should  
first pass through  
regional  
integration**

**Transition from the  
concept of  
enterprises to the  
concept of trading  
companies**

## What is the Price of Delaying Reforms?

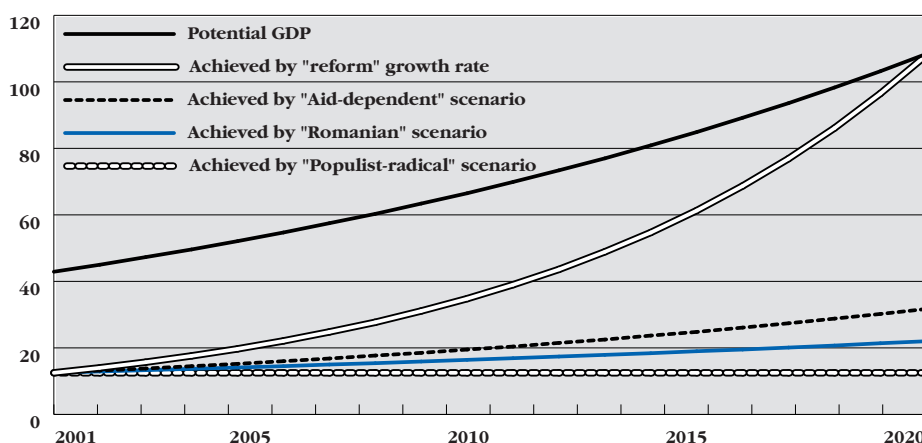
The political disputes within the leading coalition, although the parties included consider them insignificant, cause immeasurable damage in the view of the future.

In MAP, there is an evaluation of economic damage resulting from the previous "national" politics of catastrophic economic policy, UN sanctions, and NATO bombing.<sup>1</sup> The estimated damages range from 150 billion USD to a fantastic 700 billion USD, depending on the assessed period of time and required growth rate for economic recovery.

Since October 5th, it has become sensible to deal with the evaluation of economic damages done so far, as well as long-term economic damages owing to the late implementation of the basic economic reforms and confused approach to the reforms full of political frictions. On the graphic that shows the difference between potential economic development since 1989 if we hadn't experienced the prior misfortunate period, and so far actual and projected economic movements, there should be added a new "curve" showing economic damages caused by the new authorities in Serbia.

The responsibility of the former regime is a final variable and it's time to start estimating the damage caused by the acts of the new authorities (the acts that are more political than economic). The former regime can not be guilty and responsible endlessly when objectively considering current problems.

Potential GNP and Alternative Scenarios of GNP Growth



In the year 2001, GNP growth is estimated to range between 5 – 6%, but mainly due to the successful agricultural year (more precisely, the catastrophic agricultural situation in the year 2000 set a favourable basis for this year's growth). Therefore, we'll start dealing with the estimation of potential loss of GNP with the year 2001 as a basis. The basic assumptions for the estimation are the following:

- The achieved GNP in 2001 is 12.5 billion USD<sup>2</sup>; the potential GNP, according to the assumptions presented in Mr Stamenković's estimation is 42.9 billion USD, meaning the price of the former regime is 30.3 billion USD in this year.
- The potential GNP growth rate is 5%, while the "reform" growth rate is 12%. The potential and real GNP are equalized at the level of 108 billion USD in 2020.
- The reformed, or better said "heroic" growth rate (the recovery, since the growth will start after achieving its 1989 peak) might be met, in spite of IMF and World Bank projections (5%) only if (1) reform of the banking system continues at its current pace; (2) there is a concept of a social program and legislation on employment and labour that will keep social discontent reduced to the irrelevant level; (3) the dynamic start of the process of privatisation; (4) agreement with Paris and London Clubs of creditors under the most favourable (Napoli) conditions; (5) corruption and economic criminality is stopped in order to motivate the development of healthy private entrepreneurship (based on good ideas, working enthusiasm and abilities, etc).

There are three different scenarios brought into the calculation: the Aid-dependent, the Romanian, and the Populist-radical.

- The aid-dependent scenario would mean full acceptance of advice on the implementation of economic policy given by international financial and creditor institutions. In that case, the estimated growth rate of GNP would be 5%.
- The Romanian scenario would mean "stagnant growth" of GNP owing to the stop – go approach to reforms following a lack of political strength and social consensus for the energetic implementation of necessary reforms. There would be some growth whatsoever, in spite of its modest rate because the external conditions for the development of economic relations with the international community are achieved; it would bring numerous positive effects (reallocation of resources according to comparative advantages). The estimated growth is 3%.
- The Populist-radical scenario is brought into the calculation as an alarming warning. It means the continuing of the hypocritical policy of protection of the widest layers of the population from the evil international community, while the political elite and privileged oligarchy gain the profit. The growth rate is estimated at 0%.

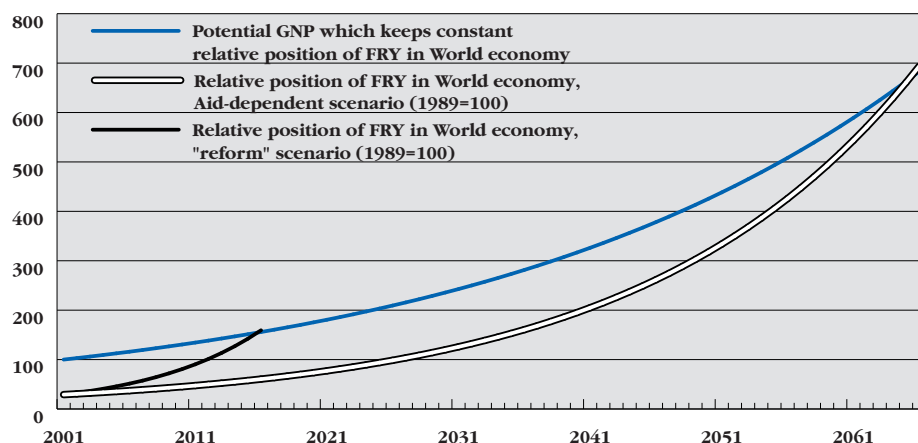
With regard to these newly introduced premises, the results would be as following:

<sup>1</sup> Stojan Stamenković, "About Price of Events in Previous Decade", MAP, 11/1/1999, pp. 25 – 29.

<sup>2</sup> We haven't adapted GNP projected on the basis of the rate of exchange of dinar at the market for this year. That will be much lower. According to the purchasing power of the domestic exchange (PPP), GNP is significantly higher. Continuous appreciation of dinar in subsequent years will equalize GNP to the rate of exchange of dinar at the market with GNP projected in the aforementioned work.

- The "economic cost" of the former regime remain the same as in Mr Stamenkovic's calculation – 707 billion USD, of which 193 billion realized in the period 1989 – 2000, and 514 billion USD remained as a reason to keep accusing the former regime. The value of "the economic cost" in three other scenarios is built up on these expenses.
- The "reform" growth rate doesn't cause additional costs, but only the realization of aforementioned 514 billion inherited from the former regime. In the year 2016 FR Yugoslavia would achieve the relative position in the world economy that we had in 1989.
- The aid-dependent scenario, with the estimated growth rate of 5% means a new loss of GNP to the amount of 488 billion USD. Considering the average long-term growth rate of the world economy, we would not achieve the 1989 relative position in the world economy by the year 2066.

#### Catch-up Process - Achieving the 1989 Relative Position in the World Economy

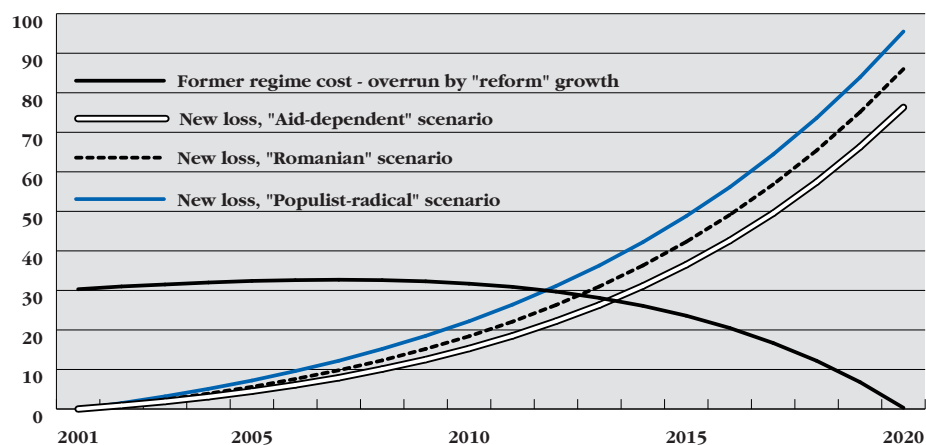


- The Romanian scenario would create an economic cost of 567 billion USD, meaning the damage of 78 billion USD more than in the aid-dependent scenario. Considering that the estimated growth rate is equal to the long-term growth rate of the world economy, the catch-up process would never start.
- The Populist-radical scenario brings a cost of 653 billion USD, a hardly imaginable amount that shows the most citizens of Serbia are not yet aware how much the former regime cost us. In addition to the economic cost of the former regime, it would come up to the amount of 1360 billion USD.

The basic conclusions that might be drawn out of these estimations are the following:

- The "reform" growth rate appears as fantastic, but with regard to the worn-out production resources, it is unfeasible. But the growth rate should not be based on "the rich national resources", "the agriculture as a comparative advantage", etc. but on the fast establishment of prerequisites for the development of entrepreneurship, and as efficient as possible an allocation of resources in reference with the comparative advantages of Serbia (or the FRY, since Montenegro is at the level of the statistic error in each calculation of the economic aggregates except for tourism). For the success of this version of economic recovery, it's necessary to have a consensus among the state, capital, and labour on the equitable distribution of expenses of the reform in order to enable all interest groups to enjoy the subsequent economic prosperity.

#### Separating of the Former Regime Loss from the Loss Caused by Delaying Reforms (USD bil.)



- The other three "development" scenarios, regardless of the different growth rates, make new economic costs that are, on a long-term basis, equal to the costs of the former regime. (The Populist in 2019, the Romanian in 2020, and the aid-dependent in 2021.).
- The only alternative to the determined implementation of the reforms is to maintain hopelessness, meaning biological disaster of the population (we have already experienced spiritual, ethical and economic disaster, but the economy is, as opposed to two other categories, more dynamic category), since the new young generations will seek a chance for normal life out of this country.

## Towns and Factories\*

With the restructuring of the factory "Zastava" in Kragujevac, the Serbian Government has started a very important part of the process of structural adaptation. It represents a finally begun process of solving the problems inherited from the socialist self-management enterprises-giants. These enterprises were often founded because the powerful politicians of the time wanted to build factories in their hometowns to be remembered by future generations. It was unimportant if and in what period of time the production programme would prove as efficient. This question was not taken into consideration at the time, since no one had responsibility for the potential inefficiency of invested resources. The main objective was to employ a growing number of people moving to the towns from their villages. The achieved loss was being booked and cumulated year after year and, marked as a quasi-fiscal deficit, was covered with inflation.

The problem of redundant labour was noted as early as at the beginning of 1970s, and especially in the middle of decade, when full decentralization of the management in society, economy and individual enterprises was carried out. The so-called "OURization" of enterprises produced a large number of administrative workers. Thus, for example, the available information show that Smederevo Forge "Sartid", while employing 10,000 workers, had about 1,000 employees in the food department, 3,500 in the construction department and a huge administration, so that less than a half of employees worked in production.

Within SFR Yugoslavia, Serbian political leadership agreed on carrying out the development strategy dominated by the programmes of production of food, energy and raw material. This, in the view of gaining a certain degree of profitability rather than an "unfavourable" economic structure had a significant impact on the efficiency of the Serbian and Yugoslav economy. Under conditions of a non-market-oriented system, the unsuitable development policy applied on the small and relatively undeveloped areas like Serbia, where inefficiency of the economy made our goods uncompetitive on the world market, lead the country to an economic crisis of large dimensions, which finally turned into a deep crisis of the political system.

In certain towns, the so-called political factories emerged: "Zastava" in Kragujevac, "RTB" in Bor, "Sartid" in Smederevo, and factories for electronic and mechanical industry in Niš. Except for Niš, these towns were worldwide recognized for their factories.

### Transition and Towns Recognised for Their Factories

Kragujevac, Bor, Smederevo and Niš in the period of self-management socialism stood as different poles of development. According to the number of employees per 1000 inhabitants in 1989, these towns were far above the average in Serbia (without Kosovo and Metohija), with the exception of Smederevo that approached the average. Over 50% of all employees were employed in industry and mining. In 1989, when former Yugoslavia had started a transition, the national income per inhabitant was over 10% higher than Serbian average: in Niš it was 12.5% above the average, but in Smederevo it was 2.9% below the average. The share of industry and mining in total national income exceeded 70% in Bor, in Smederevo (with participation of the agricultural area of 83% in total) it was near 60%, as well as in Niš (60%).

Table 1: Towns; Characteristics of Development

Town	Year	Agricultural Machines (%)	Population June 30	Population Increase/ 1000 inh.	Employed per 1000 inh.	Empl. in Economy (%)	Empl. in Industry, Mining, %	Unempl. per 1,000 inhab. (31.12.)	NI per inhab. (Ser. w-out K. & M.)	Social Ownership Share in NI, %	Industry & Mining Share in NI, %
Serbia w-out K & M	1989	66.2	7,947,000	0.8	299	82.0	41.0	55	100.0	86.9	47.8
Kragujevac	1989	65.9	7,781,000	-3.8	252	76.5	40.7	89	100.0	25.4	30.5
	1999	65.6	177,000	4.6	400	86.3	53.8	58	71.3	89.1	37.9
	1999	65.6	181,700	-1.7	336	79.0	46.9	92	50.1	43.2	24.1
Bor	1989	48.5	58,800	3.4	406	85.0	54.5	52	202.5	96.7	72.4
	1999	48.5	59,700	-2.9	350	83.0	55.9	82	87.0	78.5	62.3
Smederevo	1989	82.9	114,900	4.5	292	85.8	49.8	53	97.1	87.5	58.3
	1999	82.1	117,300	-1.0	242	79.5	52.0	95	50.1	31.6	-7.6
Niš	1989	62.9	244,200	4.2	403	82.7	45.2	101	112.5	94.5	59.5
	1999	62.3	251,100	-2.1	322	76.8	39.1	162	102.8	38.9	26.8

\* NI - National Income

Source: Republic of Serbia municipal data; Republic Bureau of Statistics

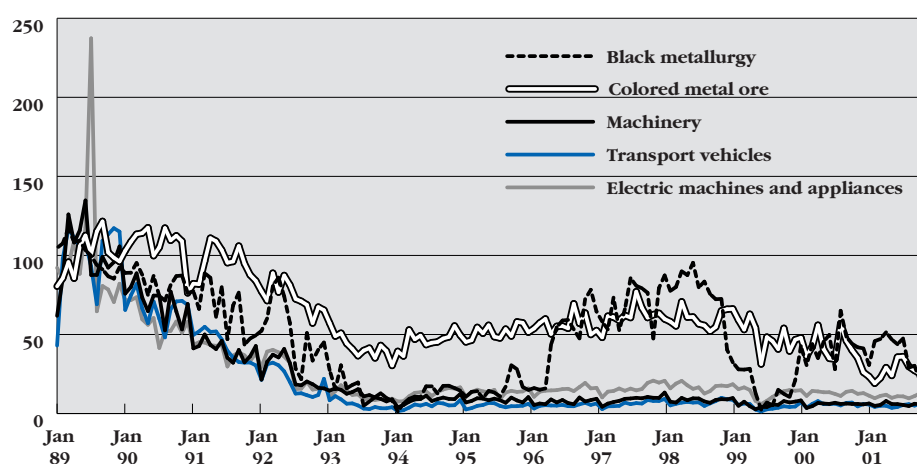


The production level in these factories, as leading factors of the development there, in September was down 74-94% compared to the 1989 average.

Serbia Without Kosovo and Metohija					
	Black Metallurgy	Colored metal ore	Machinery	Transport vehicles	El. machines and appl.
Index Average 1989 = 100	100.0	100.0	100.0	100.0	100.0
September 2001	20.4	25.2	5.8	6.1	12.9

Since 1989, the physical volume of production in the aforementioned branches has trended downward. Since 1993 extremely low levels of production were maintained in machinery, transport vehicles, and electric machines and appliances.

Industrial Production (1989 average = 100)



The data show there had been a reduction of total number of employees in industry and mining in the period 1989 -1999. However, the reduction is much less compared to the decrease of real production volume, pointing to the fact these towns will face a great problem of redundant labour that should be solved through the restructuring enterprises-giants on their territories.

This is a very delicate problem that must be solved as painlessly as possible. But the problem is inevitable, and according to our analysis the sooner we start solving it the lesser the social costs. The restructuring of factories should provide a significant increase in factor productivity, where new knowledge and skills should come to their full expression. This is the only path to increase the competitive position of their products on the domestic and world markets. It is also a condition for the reduction of state budget pressure and for a successful implementation of the process of privatisation of factories or their newly founded separate parts. The engagement of high quality management teams in the enterprises and their particular parts is required, as well. The new Law on employment will have a simulative impact on efficiency and will speed up the process of restructuring Serbian enterprise – giants.

Table 3. Towns - Employed

Town	Year	Total Employed	Employed in Industry & Mining	Industry Share in Total No. of Employed, %
Kragujevac	1989	70,764	37,364	52.8
	1999	61,036	23,840	39.1
	1999/1989	86	64	
Bor	1989	23,894	12,956	54.2
	1999	20,920	11,186	53.5
	1999/1989	88	86	
Smederevo	1989	33,556	16,479	49.1
	1999	28,443	12,758	44.9
	1999/1988	85	77	
Niš	1989	98,347	43,936	44.7
	1999	80,937	29,222	36.1
	1999/1989	82	67	

Source: Republic of Serbia municipal data; Republic Bureau of Statistics

### An Estimation of Required Workers and Redundant Labour

The restructuring of the mentioned factories is not only important in order to attract domestic and foreign investors who are to provide the currently non-existent floating capital, but also for the sake of improvement of the efficiency of the whole Serbian economy. The restructuring of Zastava in Kragujevac serves as an interesting case for projecting forward estimation of the required number of employees for (1) the current labour productivity level, and (2) the projected level of labour productivity after restructuring is realized.

Table 4. Towns - Factories for Restructuring

Factory	Kragujevac	Bor	Smederevo	Niš
<b>Employed</b>				
Zastava	25,086			
RTB		13,018		
Sartid			8,850	
Electronical Industry & Machinery Industry				15,000
<b>Estiamted Number of Employees Needed</b>				
Zastava	11,495			
RTB		3,400*		
		6,500**		
Sartid			3,300*	
			4,000**	
Electronical Industry & Machinery Industry				3,000*
				7,000**
<b>Estiamted Manpower Surplus</b>				
Zastava	13,591			
RTB		9,618*		
		6,518**		
Sartid			5,550*	
			4,850**	
Electronical Industry & Machinery Industry				12,000*
				8,000**

\* According to the production level

\*\* In case of increase of production

Although the data from the previous table should be considered conditional due to the lack of relevant information for more precise assessments, it might be concluded that the mentioned factories have relatively high redundant labour. Therefore, the main objective of the analysis is to point to the possible problems that the management and employees in these enterprises, mayors and Serbian Government are to face very soon. It is early for more precise assessment of the effects of the social programme applied in "Zastava" with regard to its applicability in the other similar factories. But, the most significant specific characteristics of some of the analysed towns relative to Kragujevac (see Table 1) lead to the conclusion that the social programme applied in "Zastava" could not be applied in the same way in the other factories.

### Characteristics of the Social Program for Zastava

In 2000, "Zastava" Group had 29,882 employees in 47 companies, with 25,086 employees out of this number working in Kragujevac - 40% of the labour market in Kragujevac.

Employees who found themselves on the list of redundant labour could choose from the following options:

1. To join the enterprise "Zastava Employment and Education". These employees are to be treated as if there is a temporary lack of need for their work. They are promised a new post in the next four years, but if this term expires without a position offered the enterprise is not allowed to discharge them. They are provided 45% of the salary they would earn if they had stayed at their former posts.

2. To quit their jobs and to apply at the Republican Bureau for the Labour Market. Under the law, they have legal right to pecuniary compensation of 60% of their last salary for a duration that depends on the number of years of service (for details, see Economic Review, 0109). The sum can not be less then 40% or more than 80% of the average salary of the employed in economy.

3. To accept a separation compensation in the amount of 200 DM in domestic exchange for each year of service.

All funds necessary for realization of the program are provided from the budget of the Republic of Serbia and the Transition Fund.

All the enterprises that are not engaged in the final production or in the sale of vehicles were divided from "Zastava Group". Twenty dependent production enterprises and 9 dependent service-providing enterprises were broken off the parent firm. The division into smaller units and into independent enterprises generates more responsibility and greater motivation for profit making both in the management and among employees.

In agreement with "Zastava Group", the Serbian Government promised to provide a sum of 5 million DEM in the form of favourable credits for the development of small business in the Kragujevac region through the Agency for Development of Small and Medium Enterprises founded on August 1. All employees of "Zastava Group" identified as redundant labours have equal rights to be granted a credit. The state also promised basic investments in fixed assets and working capital in order to maintain a minimum level of productivity until a new private partner appears.

### Conclusion

The magnitude of redundant labour in industrial factories is evident, as is the fact that the towns where the factories are situated can not deal with this issue by themselves. The assistance of the republic Government and Republic Bureau for the Labour Market is necessary. While a short-term burden to simultaneously support both higher social payments in the face of rising unemployment as well as more proactive credit schemes and retraining, neither approach can maximise its returns in the absence of the other.

Until now, wages for redundant labour have been paid by the factories, either through paid leave or by paying worker to stand idle at their station. In future, funds for the temporary unemployed won't be provided by the factories, but from the Budget and other special Funds, including the Republic Bureau for the Labour Market. This change, though logical from an economic perspective, may produce social tensions that can be politically exploited by those who resist reform. Therefore, it is very important for the employees to be informed on their future financial position within the factories that are planned to undergo the process of restructuring, and of the options and benefits that await them should they be let go. The local authorities and local media, together with experts, should have a leading role in keeping employees informed.

It also is essential to tailor labour market relief and renewal to local conditions. "Zastava" had a relatively high ratio of redundant labour compared to the other mentioned enterprises-giants. Moreover, compared to Smederevo and Bor, Niš is a town with a diversified economic structure that requires a social programme compatible with local conditions. RTB Bor's economic and social situation is quite different compared to Smederevo. Though "Sartid" employs more than half of the registered local labour market, the local wealth in fertile agricultural land points to the possibility of a different type of social programme than in either Niš or Bor.

It is reasonable to expect a faster increase of unemployment in the towns with the highest concentration of labour in the factories-giants, but this is by no means due to bad policy of the new Government. The process of restructuring initiated in Serbia has not prompted the issue; it only helped to identify the problem of redundant labour and finally to start solving it.

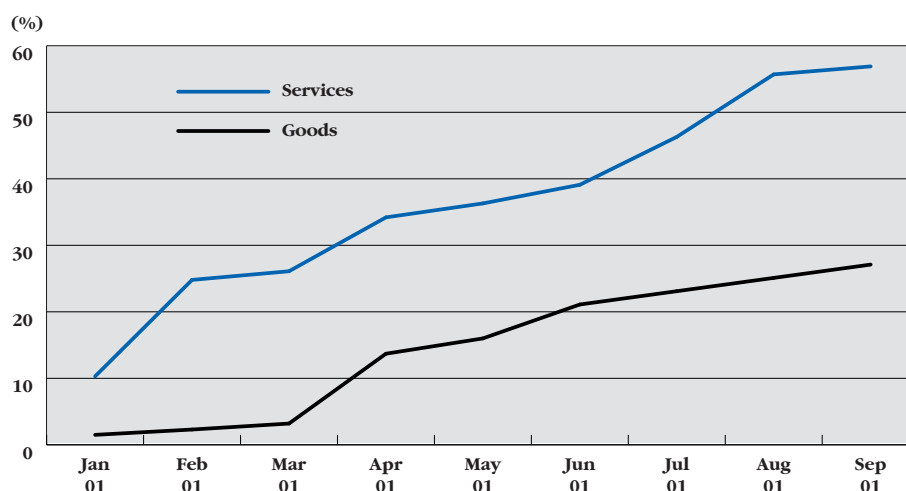
In addition to active and passive labour policies, a significant factor in the solution to the problem of unemployment will be the increased mobility of labour expected after the adoption of legal regulations based on a market-oriented concept of enterprises. The low mobilisation of domestic labour is, above all, due to the current labour legislation that supports firm relations between the employees and the factories they work in. Serbian workers are not used to changing their work and living place, but it will become a usual practice in the course of time.

## MACROECONOMIC REVIEW

### Prices

In the course of September, retail prices in Serbia were up 1.4%, making total inflation measured by retail prices for the first three quarters 32.9%. In July and August, the prices of services grew faster than the prices of goods. Growth was mostly influenced by two price corrections in telephone services and partly by price adjustment to some transport services (taxi and public transport organized by private companies). The prices of services in September was up 1.5%, exceeding the 0.8% growth in the prices of goods. The increase in the prices of goods was mainly due to the 3.2% rise in price of a group of industrial food products. In this group, there was a correction in the price of fresh meat, meat products and cooking oil. *Industrial producer prices were up 1.5% in September.* In the last three months, industrial producer prices have showed constant growth.

Rate of Price Growth (January-September 2001)



Year-on-year inflation measured at the level of prices in September is 101.5%. Since September 2000 was the last month prior to the liberalisation of prices, huge differences in month-to-month inflation and other inflator indicators in view of the annual level are gradually to decrease in upcoming months and to completely disappear at the beginning of the next year. Examining inflation in the third quarter of this year, there is a noticeable downward trend. The cumulative inflation rate for the first nine months of this year, relative to the last year, shows a moderate decrease compared to the cumulative rate for the previous two months. Unless there is a significant correction in the rest of prices, such a dynamics is to be expected in the fourth quarter as well.

Monthly Indices of Price

2001	I	II	III	IV	V	VI	VII	VIII	IX	I-IX
CPI	103.2	101.5	102.3	111.3	103.5	104.7	101.8	102.9	101.8	137.9
Food, beverages, tobacco	100.8	100.1	103.0	110.0	104.4	101.6	101.4	104.2	103.0	132.0
Living Nutrition	99.4	100.9	106.6	117.3	102.0	103.0	101.7	109.0	103.2	150.7
Foodstuff <sup>a</sup>	101.7	99.6	100.5	105.2	106.1	100.6	101.2	101.0	102.8	119.5
Housing	113.9	102.6	102.7	127.6	101.2	119.1	100.5	99.9	100.3	186.0
Electricity	100.1	100.0	100.0	159.3	100.0	139.7	100.0	100.0	100.0	222.6
Utilities	189.3	108.4	101.9	102.1	103.4	100.6	100.4	102.0	101.5	231.0
Rent <sup>b</sup>	111.0	104.4	106.4	94.3	102.2	97.9	101.3	99.2	100.3	127.3
Transport and Telecommunication	103.5	104.5	100.0	109.4	100.3	102.5	118.5	118.6	100.8	172.4
CPI <sup>c</sup>	102.6	101.5	101.3	104.2	104.6	101.3	101.3	100.6	101.6	119.9

Note: Cost Price Index<sup>a</sup> (CPI<sup>b</sup>) represents a basic inflation indicator. It has been calculated on the basis of the CPI, from which bread, meat and milk, electric power, public utilities, transport and postal services have been deducted. In addition, 33.4%

Source: Republic Bureau of Statistics

The dynamic of faster growth in cost of living than in retail prices continued in September. The cost of living was up 1.8% on average. Cost of living index growth was largely due to 3% growth in the price of basic nutrition. Growth in the prices of basic nutrition was significantly influenced by the rise in the prices of fresh meat and meat products, which have a high weight (0.1558) in the consumer basket, as well as by the higher price of cooking oil.



*The costs of living grew 37.9% from the beginning of this year to the end of September.* Cumulative inflation measured by the cost of living year-on-year in September was 97.3% and is significantly down relative to the cumulative rate in the previous month (114%). The cost of living in the previous quarter shows the same tendency as retail prices.

In the first three quarters of this calendar year, the highest growth was noted in prices of public utilities (131%) electric power (122.6%), transport and postal service (72.4%), followed by prices of basic living necessities (50.7%). A donation of the European Agency for Reconstruction financed the import of electric power, thus enabling the electric energy sector to offer some concessions in the third increase in prices this year, previously set for 40%. The final average 15% rise for the price of electric power alleviates growing social tensions and enables the Republic Government to sustain its strict wage policy in the public sector without violating strict budget limitations.

Of the total 37.9% inflation measured in cost of living units, almost two-thirds are due to the share of transferred inflation which includes the correction of the disparity in prices of bread, milk, meat, electric power, public utilities, transport and postal services. Our basic inflation index show a 19.9% increase in the 66.6% remaining prices of products and services that are included in consumer basket in the first nine months of this year.

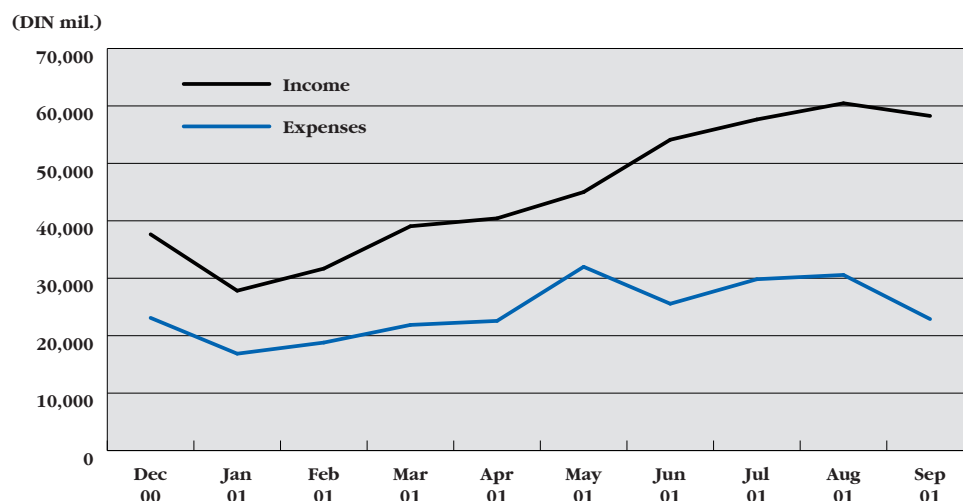
### Wages

According to the data of the Republic Bureau of Statistics, the average nominal net wage in September in Serbia (without food allowances and transport compensation) was 6210 dinars or 203 DEM applying the accounting method effective until June 1, or 6900 dinars or 226 DEM according to the new methodology. The average gross wage was 9940 dinars or 326 DEM according to the current foreign exchange rate. Although the average wage in September expressed in DEM grew by 1.3% compared to the previous month, an analysis of data for three previous months points to a deceleration in total wage growth in September.

The difference between the average net income expressed by the current and by the previous methodology was 11.1% this month. In September, the average net wage (according to the previous model of accounting) displayed a nominal increase of 1.9%, while the real increase of the average net wage (corrected for the cost-of-living) was only 1% compared to the previous month. The average wage calculated in September this year shows a real increase of 22.2% year-on-year, while the average for the first nine months of the year 2001 was up 9.1% in relation to the same period last year.

According to monitoring of the monetary flow by the Republic Bureau for Accounting, income in FRY nominally dropped by 3.6% compared to August. Of a total 58.3 billion dinars, 10.1% less was paid in gross income to the employed compared with the amount in dinars paid in the previous month. The total amount of mandatory pension contributions of 15.8 billion dinars remained essentially identical to August payments. At the same time, the total sum collected from the population was significantly reduced - registering at 22.9 billion dinars, a nominal drop of 25.1%. The sums received in terms of realized goods and services were nominally down 28.2%, while tax and contributions collection were down 12.3%. The sum received in terms of realized goods and services (18.1 billion dinars) and tax and contributions collections (3.7 billion dinars) comprised more than 95% of the structure of total collected amounts.

Income and Expenses of Citizens of FRY



## Labour Market

The registered unemployed, compared to the registered employed in FR Yugoslavia in August 2001 was 29.9%, 3.9% growth year-on-year. The unemployment rate in August 2001 in Serbia was 29.2%, and in Montenegro 39.2%.

In the year 2001 the decrease in total number of the employed slowed, compared to prior years. In the period January – August 2001, the total number of employed dropped only 0.36% year-on-year. The number of employed in the former socially owned sector was down 2.58%, while in the private sector it was up 12.42%.

The number of registered unemployed in Serbia in September 2001 reached 775,356 persons, which is up 5.5% year-on-year. The growth rate of the number of unemployed for the period January – September 2001 was 6.4% compared to the same period last year.

Examining the structure of the unemployed according to educational level, the largest number is of persons with incomplete or completed primary school (38.45%). The highest unemployment is present among those with three-year or four-year secondary school education (54.53%). The remaining 7% include persons with advanced and university-level specialist's training.

The gender structure of the unemployed was relatively steady in recent years. Women make up about 56% in total number of the unemployed.

The number of vacancies registered at the Republic Bureau for Labour Market in the period January – September 2001, is up 20.7% year-on-year. About 73% of the total number of registered vacancies are filled monthly through permanent employment.

## Industrial production

Industrial production in the FRY was up 5.5% month-on-month. In Montenegro, production was up 2.4%, while in Serbia it rose 5.7%. In Central Serbia production was up 4.3%, while in Vojvodina it rose 8.2%.

The de-seasonal index for September shows a drop in production of 1.1% month-on-month.

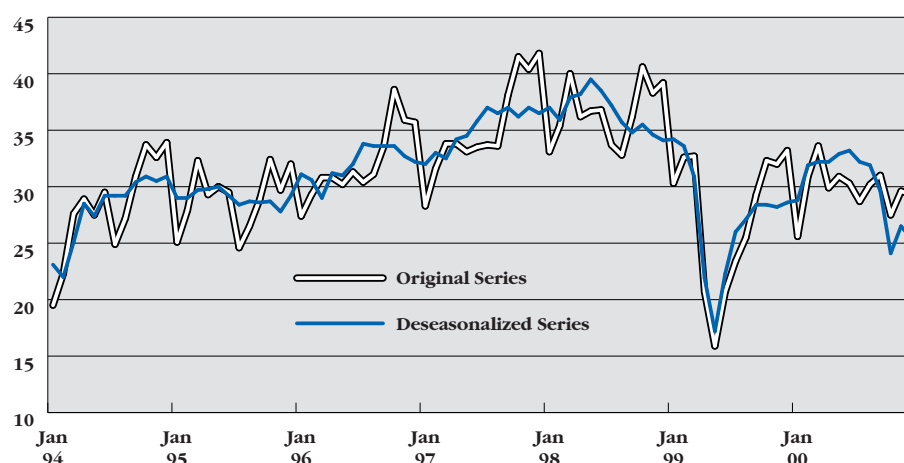
Industrial production in the FRY in September 2001 was down 4.9% compared to the same month the previous year when the same seasonal factors were effective. In Montenegro, production was down 2.2%, while in Serbia it fell 5.1%. In Central Serbia production dropped 11.7%, while in Vojvodina production was up 9.1%.

Industrial production in the FRY for the period January – September 2001 fell 3.5% compared to the same period last year. In Montenegro production was down 0.6%, while in Serbia it fell 3.7%. In Central Serbia production fell 7.9%, while in Vojvodina it increased 6.0%.

In the area of energy production, production of petroleum and petroleum products was up 57.4% month-on-month, while production of coal fell 11.3%. Compared to 1989, the production of energy was significantly down in September 2001: production of petroleum and petroleum products was down 26%, production in the electric industry fell 26%, production of coal fell 18%, and the production of gas and oil was down 12%.

Since the beginning of this year, the import of materials for reproduction has significantly increased in Vojvodina compared to the same period last year, while in Central Serbia it stagnated (in September it fell more than 20% compared to August). This means the increasing tendency in Vojvodina of industrial production will continue, while recovery in Central Serbia can not be expected soon.

Industrial Production in FRY (1989 average = 100)



## Foreign trade

Preliminary data on foreign trade indicate that commodity exports in September were valued at 157 million USD, while commodity imports were valued at 293 million US\$. Export in September was up 10% year-on-year (measured in nominal US\$), while import was up 7%. For the first nine months of this year, commodity exports are valued at 1.2 billion US\$, which is up 4% year-on-year, while commodity imports were up 19% and reached the value of 3 billion US\$.

These trends have resulted in a downward revision to the previously targeted foreign trade growth rate in the FRY. *According to the new official projection, the expected growth of the value of commodity exports is 3.4% year-on-year* (as opposed to the previously expected 7.3%), *while exports are expected to increase 21%*. Such projections are not unrealistic and correspond to this year's trend, 3.5% growth of exports and 21.1% growth of imports at the federal level, relative to the first nine months of the last year.

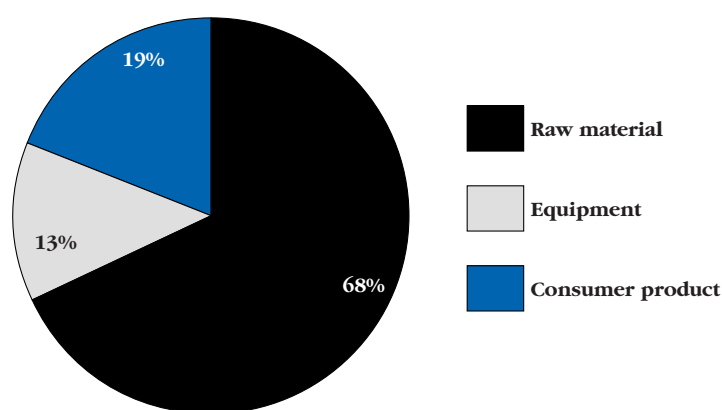
*The monthly trade balance deficit is significantly lower compared to the first five months of this year*, which is primarily related to a lower import volume, but also from a slight increase in export. Thus, the foreign trade deficit in Serbia in September was 136 million US\$, and from the beginning of the year it is valued at 1.8 billion US\$.

Nevertheless, the expected current balance deficit is 1.5 billion US\$, which is a little less than the previously expected 1.8 billion US\$. This deficit is due to an increase in the net influx of services and net transfers, which are expected to continue rising to the end of the year. Thus, the hard currency influx at the base of services was up 40% for the first seven months of this year compared with the same period last year.

In the most significant sectors of industrial processing there was an increase in the value of import of raw material and semi-finished products, indicating a possible increase in production by the end of the year, and probably of export of finished products. The highest increase in September was achieved in the leather industry and production of rubber and plastics. These also stand as the most important export sectors.

On the other hand, the effects of the last year's drought are visible in the trade balance for the whole year. There has been a significant decrease in the export of food. The export of fodder and grain was hardest hit. The structure of agricultural and food product export is largely unfavourable, dominated by unprocessed products or products in a low stage of processing. Thus, for example, live stock export is at almost the same level as in the last year, while the export of meat and meat products were reduced by half.

Structure of Import in Serbia



The structure of export according to sector is similar to the last year. Raw material makes up two-thirds of export, but has a downward tendency. Consumer product import is slightly up. The export of equipment shows a significant increase of over 40% year-on-year, but off of a low base. The value of import in this category of products is 75% less than the value of import.

Since the beginning of this year the fluctuation of the exchange rate is limited. In the first nine months, the extreme values of the median rate of exchange of the dinar against the DEM ranged between -0,75% and +1,91% compared to the exchange rate at the end of last year. *The mild depreciation of the nominal exchange rate will continue*, since its growth is still much lower than the increase in retail prices, so the real exchange rate continues to appreciate in the course of 2001.

However, this does not have a negative impact on demand for dinars, which remains at a very high level. The National Bank of Yugoslavia is a net buyer at the exchange

market, enabling the foreign exchange reserves of the NBY to double compared to the beginning of the year. The level of foreign exchange reserves in the second half of October was 1,075 billion US dollars, which could cover 3.1 import months (if the average monthly import value since the beginning of the year is considered).

### Monetary and fiscal policy

The Central Bank of Yugoslavia decreased the discount rate from 1.6% to 1.3% a month. This decrease in the discount rate, as well as the one applied on August 25, affect the decrease of interest rates on the money market. In the course of September, the interest rate of treasury bills ranged between 1.85% and 2.95% a month. At the Belgrade Exchange, the average interest rate on short-term securities was reduced from 4.96% in August to 4.32% in September. Total payment operations were up from 5.66 billion to 5.75 billion dinars, while the average term of these securities reached a record of 66 days compared to 36 days in August and 32 days in July. This is a positive signal, especially considering the low level of industrial activity. However, interest rates are still at a very high level and dampen the reanimation of production.

At the end of September M1 reached 52.623 billion dinars, an increase of 8.39% compared with August. The cash money supply grew 9.45% and reached 17.64 billion dinars, while deposit money increased 7.86% to 34.982 billion dinars. The primary issue resulted from provision of short-term credit of 1.7 billions to finance the budget deficit, and net purchase of foreign exchange by the Central Bank in the amount of 1.064 billion dinars. During the whole of 2001, the only source of primary issue was foreign exchange transactions, while credit financing of the budget appeared in August and September in a total amount of 3.2 billion dinars. Since foreign exchange reserves in September increased faster than M1, money supply coverage rose from 128.6% to 131% at the end of September.

Public revenue collection decreased (29.6 billion dinars) compared to August when a total of 30.37 billion dinars was collected. The revenues of the budget and other users was 18.408 billion dinars, which is 1.51 billion less than the budget revenue in August. The Republic Budget revenue dropped from 11.38 billion dinars to 10.77 billion dinars. Excise duty revenue comprised 25.56% of budget revenue, which was the highest participation of excise duty revenue so far. At the same time, the revenue of social insurance organizations reached 11.189 billion dinars, compared to 10.45 billion dinars collected in August.

The latest IMF projections indicate the total budget deficit in 2001 should be about 4% of GNP (about 27.7 billion dinars), instead of previously projected 6.1% of GNP (about 41.4 billion dinars). The deficit should be covered through: credits provided by the banking system (projected at 0.8% of GNP, i.e. 5.55 billion dinars), foreign credits (1.6% of GNP, i.e. about 11 billion dinars), foreign donations (1.2% of GNP, or 8.32 billion dinars) and revenue from the privatisation (0.4% of GNP, or 2.77 billion dinars).

Gross Payments and Public Revenues

